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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 537

GLENSHAW GLASS COMPANY, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Now COMES Glenshaw Glass Company, Inc., petitioner, by its duly authorized attorneys, and prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered on October 21, 1947. (R. 168.)

In support of this petition your petitioner respectively shows:

OPINIONS BELOW

The Tax Court of the United States prepared a Memorandum Findings of Fact and Opinion. (R. 156.) It is not

officially reported. The Circuit Court of Appeals affirmed *per curiam* without an opinion. (R. 167.)

JURISDICTION

This Court's jurisdiction is invoked pursuant to Section 1141(a) of the Internal Revenue Code, 53 Stat. 164, and the Act of February 13, 1925, c. 229, § 1, 43 Stat. 938, amending and reenacting Section 240(a) of the Judicial Code, 28 U.S.C. § 347.

SUMMARY STATEMENT OF MATTER INVOLVED

This case presents *first* the issue of whether the Administrative Procedure Act[1] governs the judicial review of decisions of the Tax Court, and, if so, whether the scope of that review has been enlarged thereby, and, *second,* the issue of whether the Tax Court's findings of fact must comply with the criteria announced in *Securities and Exchange Commission* v. *Chenery Corporation,* 318 U. S. 80 (1943); *id.* 332 U. S. 194 (1947).

On November 7, 1944, the respondent determined a deficiency in the petitioner's income and excess profits taxes for the taxable years ended September 30, 1941 and 1942. (R. 4-8.) The deficiency was predicated upon the determination that the deductions claimed for officers' salaries were excessive and unreasonable.

On October 15, 1946, the Tax Court entered its Memorandum Findings of Fact and Opinion. (R. 156-165.) The Tax Court found that the total compensation paid by petitioner to its executive officers in the taxable year 1941 constituted reasonable compensation. The claimed deduction

[1] 5 U.S.C. § 1001, 60 Stat. 237 (1946).

was accordingly allowed. The same deduction was allowed for the taxable year 1942, but the deduction of an additional amount paid in that year was disallowed on the ground that the petitioner had not sustained its burden of proving that the payment of that additional amount was not a distribution of corporate profits in the guise of compensation for personal services. Although the Tax Court discussed certain evidence bearing upon the issue of whether the disallowed amounts were reasonable as compensation, it made no finding on that issue.

In the Circuit Court of Appeals, petitioner asserted that the Administrative Procedure Act had enlarged the scope of judicial review of decisions of the Tax Court and that by virtue of its provisions the Tax Court's finding that the disallowed payments constituted a distribution of profits in the guise of compensation could not stand. The petitioner also asserted that the Tax Court's decision could not be sustained upon the respondent's alternative theory that the payments were unreasonable as compensation in view of the fact that the Tax Court had not made sufficient findings on that issue. The petitioner, relying upon the *Chenery* cases, *supra,* urged that a remand to the Tax Court was required to enable the Tax Court to consider and determine that question. And even were the findings and opinion of the Tax Court construed to contain a finding that the additional payments were compensation and unreasonable as such, the enlarged scope of judicial review established by the Administrative Procedure Act required a reversal.

The Circuit Court of Appeals affirmed the decision of the Tax Court *per curiam* and without opinion. (R. 167.)

QUESTIONS PRESENTED

1. Whether the Administrative Procedure Act governs the judicial review of decisions of the Tax Court, and, if so, whether the decision below should be reversed.
2. Whether, upon the authority of *Securities and Exchange Commission* v. *Chenery Corporation*, the court below was required to remand the proceedings to the Tax Court for adequate findings upon the issue of whether the disallowed payments were reasonable as compensation.
3. Whether the decision below should be reversed even though it be determined that the Administrative Procedure Act does not govern the judicial review of Tax Court decisions.

REASONS FOR GRANTING CERTIORARI

I.

Whether the Administrative Procedure Act governs the judicial review of Tax Court decisions, and if so, whether it enlarges the scope of that review, are important questions of federal law that have not been but should be settled by this Court.

The question of whether the Administrative Procedure Act governs the judicial review of Tax Court decisions was extensively briefed and argued in the Circuit Court of Appeals. Since that court did not write an opinion, we are unable to determine whether it held the Administrative Procedure Act to be applicable and affirmed under its authority, or held it to be inapplicable and affirmed under the authority of *Dobson* v. *Commissioner* and related cases. In any event, since a factual determination of the Tax Court was presented for review, the decision of the Circuit

Court of Appeals inevitably involved a choice between the standards of the Administrative Procedure Act and the standards of *Dobson* v. *Commissioner* and related cases, or a determination that there was no difference between the two. These are questions of great public importance that have not been but should be settled by this Court.

It is unnecessary to demonstrate to this Court the importance of its determining these questions. Petitions to review decisions of the Tax Court continue to constitute a significant proportion of the work of the Circuit Courts of Appeals.[2] Moreover, confusion exists not only over the application of the standards of *Dobson* v. *Commissioner*[3] but over whether such standards have been replaced by those of the Administrative Procedure Act[4] and, if so, over the difference between those standards.[5]

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[2] Annual Report of the Director of the Administrative Office of the United States Courts (1947) 28.

[3] "As to the Dobson case, there seems to be considerable confusion as to whether it is a precedent for anything, and, if so, for what." Hutcheson, J. in *National Bronx Bank of New York* v. *Commissioner*, 147 F. (2d) 651, 652 (C.C.A. 2d, 1945). *Cf. Brooklyn Nat. Corporation* v. *Commissioner*, 157 F. (2d) 450 (C.C.A. 2d, 1946). See Eisenstein, *Some Iconoclastic Reflections on Tax Administration*, (1945) 58 Harv. L. Rev. 477, 539-543; Note (1947) 60 Harv. L. Rev. 448; Note (1946) 45 Mich. L. Rev. 192.

[4] Contrast e.g. Note (1946) 2 Tax L. Rev. 103 (concluding that the Administrative Procedure Act governs judicial review of Tax Court decisions) with Note (1947) 56 Yale L. J. 670, 686 (predicting a contrary result).

[5] Contrast *Lincoln Electric Company* v. *Commissioner*, 162 F. (2d) 379, 382 (C.C.A. 6th, 1947), with *Anderson* v. *Commissioner*, C.C.A. 7th, Docket Nos. 9084, 9085, decided December 17, 1947, 48-5 CCH Standard Federal Tax Reports, para. 9109. See also O'Connell, J., dissenting in *Commissioner* v. *Church's Estate*, 161 F. (2d) 11, 14 (C.C.A. 3rd, 1947), *cert. granted* ..... U. S. ....., 67 S. Ct. 1738 (1947).

A. The Administrative Procedure Act governs the judicial review of the Tax Court's decision in this case.

Section 10 of the Administrative Procedure Act, 5 U.S.C. § 1001, 60 Stat. 237 (1946), provides for the judicial review of "agency action".[6]

The critical question, therefore, is whether the Tax Court is an "agency". Section 2(a), in so far as pertinent, provides as follows:

> "Sec. 2. As used in this Act—
>
> "(a) Agency.—'Agency' means each authority (whether or not within or subject to review by another agency) of the Government of the United States other than Congress, the courts, or the governments of the possessions, Territories, or the District of Columbia."

The only exception possibly applicable to the Tax Court is that it is a "court" within the meaning of Section 2(a). The statutes of the United States creating the Tax Court and the various amendments thereto, the legislative histories of such statutes, and the decisions of this Court and the Circuit Courts of Appeals make clear that the Tax Court is not a "court" but is an "agency" and, hence, that the Act applies.

The Board of Tax Appeals was established by Section 900 of the Revenue Act of 1924 (43 Stat. 336). To the extent pertinent, that section provided as follows:

> "(a) There is hereby established a board to be known as the Board of Tax Appeals (hereinafter referred to as the 'Board') . . . .
>
> • • •

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[6] Section 2(g) broadly defines "agency action". It is unquestioned that a decision of the Tax Court is "agency action" if the Tax Court is an agency.

For brevity, all sections hereafter referred to, unless otherwise designated, are sections of the Administrative Procedure Act.

> "(k) . . . The Board shall be an independent agency in the executive branch of the Government."

Section 1000 of the Revenue Act of 1926 (44 Stat. 105) amending that section of the 1924 Act, provided in part as follows:

> "The Board of Tax Appeals (hereinafter referred to as the 'Board') is hereby continued as an independent agency in the Executive Branch of the Government."

With this legislation before it, this Court had no difficulty in determining that the Board of Tax Appeals was not a court. In *Old Colony Trust Company* v. *Commissioner*, 279 U.S. 716 (1929), the Court said (at 725):

> "The Board of Tax Appeals is not a court. It is an executive or administrative board, upon the decision of which the parties are given an opportunity to base a petition for review to the courts after the administrative inquiry of the Board has been had and decided."

To the same effect is *Williamsport Wire Rope Company* v. *United States*, 277 U.S. 551, 564-565 (1928).

The Attorney General's Committee on Administrative Procedure in Government Agencies included the Board of Tax Appeals among the government agencies studied.[7]

In 1942 the name of the Board of Tax Appeals was changed to The Tax Court of the United States. That this was a change in name only is abundantly clear from the statute accomplishing the change and the House Committee

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[7] *Report of the Attorney General's Committee on Administrative Procedure*, Sen. Doc. No. 8, 77th Cong., 1st Sess. (1941); *Monographs of the Attorney General's Committee on Administrative Procedure in Government Agencies*, Sen. Doc. No. 10, part 9, 77th Cong., 1st Sess. (1941).

Report relating thereto. The applicable provision of the Revenue Act of 1942 (56 Stat. 957) is in part as follows:

> "§ 504. Change of Name of Board of Tax Appeals.
>
> * * *
>
> "(b) Powers, tenure, etc., unchanged. The jurisdiction, powers, and duties of The Tax Court of the United States, its divisions and its officers and employees, and their appointment, including the designation of its officers and the immunities, tenure of office, powers, duties, rights, and privileges of the presiding judge and judges of The Tax Court of the United States shall be the same as by existing law provided in the case of the Board of Tax Appeals. . . ."

The Report of the House Ways and Means Committee accompanying the bill when it was reported to the House of Representatives provided in part as follows:

> "Section 504. Change of name of Board of Tax Appeals.
>
> "This section merely changes the names by which the Board of Tax Appeals, its chairman and its members are known. No change is made in its status. The Board, which will hereafter be known as the United States Tax Court, is continued as an independent agency in the executive branch of the Government. Thus, its status as an executive or administrative board is unchanged. *Old Colony Trust Co.* v. *Commissioner* (279 U.S. 716, 725 (1929)). The members of the Board will hereafter be known as the presiding judge and the judges of the United States Tax Court." (H. Rep. No. 2333, 77th Cong. 2nd Sess., pp. 172-173).

The present statute accordingly reads as follows:

> "§ 1100. Status.
>
> "The Board of Tax Appeals (hereinafter referred to as the 'Board') shall be continued as an independent agency in the Executive Branch of the Government.

> The Board shall be known as The Tax Court of the United States and the members thereof shall be known as the presiding judge and the judges of the Tax Court of the United States." (26 U.S.C.A. § 1100 (1946 Pocket Part))

Following the change of name of the Board of Tax Appeals, this Court again had occasion to characterize its status as that of an independent agency in the executive branch of the government. In *Commissioner of Internal Revenue* v. *Gooch Milling & Elevator Co.*, 320 U.S. 418 (1943), the question was whether the Board of Tax Appeals had the authority to apply a prior tax over-payment against a tax deficiency. This Court took cognizance of the change of name of the Board in a footnote which reads as follows (at 418):

> "Section 504(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, 957, changed the name of the Board of Tax Appeals to The Tax Court of the United States. Section 504(b) provided that this change in name was to have no effect on the jurisdiction, powers and duties of the agency. See also H. Rep. No. 2333, 77th Cong., 2nd Sess., pp. 172-173."

The Court then went on to say (at 420):

> "The Board is but 'an independent agency in the Executive Branch of the Government,' and the legislative pattern of its jurisdiction is clear and unambiguous."

To the same effect are *Hutchings-Sealy Nat. Bank* v. *Commissioner*, 141 F. (2d) 422, 423-424 (C.C.A. 5th, 1944); *West* v. *Commissioner*, 150 F. (2d) 723, 727 (C.C.A. 5th 1945) *cert. den.* 326 U.S. 795 (1946).

Moreover, in *Dobson* v. *Commissioner*, 320 U.S. 489 (1943), this Court made clear that the standards there announced for the judicial review of Tax Court decisions were

predicated upon the status of the Tax Court as an administrative agency.[8]

Thus, prior to the passage of the Administrative Procedure Act, Congress and the courts had with unbroken consistency carefully characterized the Tax Court as an "agency" and had expressly rejected the notion that it was a "court". Accordingly, the plain meaning of these terms in Section 2(a) requires the conclusion that the Tax Court is subject to the provisions of the Act. Under these circumstances, a resort to its legislative history as an extrinsic aid to construction is both unnecessary and inappropriate. *Packard Motor Car Company* v. *National Labor Relations Board,* 330 U.S. 485 (1947).[9]

Even if reference were made to the legislative history of Section 2(a), that history would have to be conclusive to

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[8] In the *Dobson* case this Court said:

> "Another reason why courts have deferred less to the Tax Court than to other administrative tribunals is the manner in which Tax Court finality was introduced into the law. (at 495)
>
> • • •
>
> "... every reason ever advanced in support of administrative finality applies to the Tax Court. (at 498)
>
> • • •
>
> "... Tested by every theoretical and practical reason for administrative finality, no administrative decisions are entitled to higher credit in the courts. (at 499)
>
> • • •
>
> "However, all that we have said of the finality of administrative determination in other fields is applicable to determinations of the Tax Court." (at 501)

[9] In that case the Court said (at 492):

> "We are invited to make a lengthy examination of views expressed in Congress while this and later legislation was pending to show that exclusion of foremen was intended. There is, however, no ambiguity in this Act to be clarified by resort to legislative history, either of the Act itself or of subsequent legislative proposals which failed to become law."

And see *Gemsco, Inc.* v. *Walling,* 324 U. S. 244, 260 (1945).

overcome the compelling force which must be attributed to the plain meaning of the statutory language and the prior authoritative determinations of the Tax Court's status as an agency. As a matter of fact, the legislative history preponderates in favor of a Congressional intention to include the Tax Court within the coverage of the Act.

During the course of the explanation of the bill on the floor of the Senate by Senator McCarran, Chairman of the Senate Judiciary Committee and chief proponent of the bill in the Senate, the following exchange took place with respect to Section 6(a) of the Act which states that "Every party shall be accorded the right to appear in person or by or with counsel or other duly qualified representative in any *agency* proceeding":

> "Mr. Ferguson. Let us consider the Tax Board. Could the Board itself determine that certain individuals were qualified to appear and that other persons were not qualified to appear?
>
> "Mr. McCarran. The answer to that question is 'No'. The Board could not do so. The Board would have to accept lawyers or nonlawyers, as the case might be, because a tax expert may not be a lawyer." (Legislative History, Administrative Procedure Act, Sen. Doc. No. 248, 79th Cong., 2nd Sess., pp. 317-8)[10]

In their consideration of the Administrative Procedure Act, both the House and Senate Judiciary Committees relied heavily upon the Report of the Attorney General's Committee on Administrative Procedure in Government Agencies (*supra* n. 7). The House Committee Report expressly refers to the fact that the Attorney General's Committee included the Board of Tax Appeals among the

[10] The entire legislative history of the Administrative Procedure Act has been reproduced in the one Senate document cited above. For convenience all subsequent references to the legislative history of the Act will be to the page number of Sen. Doc. No. 248.

government agencies studied (Sen. Doc. No. 248, pp. 233, 245-6). Similarly, the Senate Judiciary Committee's print of the bill expressly states that "The Committee has also had the benefit of . . . the monographs issued by the Attorney General's Committee respecting each important Federal agency. . . ." (Sen. Doc. No. 248, p. 11). As heretofore indicated, one of the monographs was devoted to a study of the Board of Tax Appeals (*supra* n. 7). Thus, Congress was clearly conversant with the treatment and recognition of the Board of Tax Appeals as an agency.

Also, the explanation of the term "agency" in the Senate Judiciary Committee's print of the bill states that the term is defined substantially as in *inter alia* the Federal Register Act (Sen. Doc. No. 248, p. 12). The Federal Register Act (44 U.S.C. § 301, 49 Stat. 500) requires the publication in the Federal Register of certain documents promulgated by federal agencies, and this requirement has been construed to be applicable to the Board of Tax Appeals and the Tax Court.[11] The borrowing of this definition for purposes of the Administrative Procedure Act carries with it this consistent and continuous administrative construction.

The evidence relied upon by respondent to indicate that the term "court" as used in Section 2(a) was intended to include the Tax Court is contained in a lengthy appendix to a letter from the Attorney General to the chairmen of the House and Senate Judiciary Committees. Without explanation or discussion to show that the matter had been carefully considered and the relevant data examined, the appendix to the Attorney General's letter merely stated

[11] See the Federal Register Regulations prescribed by the Administrative Committee of the Federal Register (1 CFR Cum. Supp., p. 29). These regulations required the publication in the Federal Register of the Rules of Practice and Procedure of the Board of Tax Appeals. The Tax Court's rules of practice are likewise published in the Federal Register. See *e.g.*, 8 F. R. 1781.

that the term " 'Courts' includes the Tax Court, Court of Customs and Patent Appeals, the Court of Claims and similar courts . . ." (Sen. Doc. No. 248, pp. 224, 408). Such a cursory, cavalier statement cannot be permitted to overcome the pre-existing Congressional and judicial determinations, the plain statutory language of Section 2(a) and the countervailing legislative history.

That letter from the Attorney General should be contrasted with one dated July 3, 1942, from the Attorney General to the Chairman of the House Committee on Ways and Means. In that letter, written in connection with the proposed change of name of the Board of Tax Appeals, the Attorney General said:

> "The Supreme Court has repeatedly characterized it as an administrative body exercising quasi-judicial powers (*Old Colony Trust Co.* v. *Commissioner* (279 U.S. 716; *Goldsmith* v. *Board of Tax Appeals* (270 U.S. 117). Its administrative status has been held sharply to distinguish it from a court. *Cf. Blair* v. *Oesterlein Machine Co.* (275 U.S. 220) with *Williamsport Co.* v. *United States* (277 U.S. 551). Its jurisdiction is limited by statute. It does not have authority to enforce its decisions (*U.S. ex rel. Girard Co.* v. *Helvering* (301 U.S. 540, 542)); nor does it possess any of the inherent powers of a court. It is in no sense a part of the judicial branch of the Government."[12]

The Circuit Court of Appeals for the Sixth Circuit has held the Tax Court to be an "agency" subject to the Administrative Procedure Act. *The Lincoln Electric Company* v. *Commissioner,* 162 F. (2d) 379, 382 (1947).

The Administrative Procedure Act being applicable to the Tax Court, Section 10, providing for the judicial review

[12] Quoted at 93 *Cong. Rec.* 8555 (July 7, 1947).

of agency action, is applicable to this proceeding. Section 12 provides in part that:

> "This Act shall take effect three months after its approval except that Sections 7 and 8 shall take effect six months after such approval. . . ."

The Act was approved on June 11, 1946. All of its provisions except those specifically referred to in Section 12 became effective on September 11, 1946, including, of course, Section 10 relating to judicial review.[13] The petition for review of the decision of the Tax Court in this case was filed in the Circuit Court of Appeals on February 17, 1947. (R. 166.)

B. The scope of judicial review of Tax Court decisions is enlarged by the Administrative Procedure Act.

Section 10(e) provides the starting point for a determination of the scope of judicial review. It is as follows:

> "(e) Scope of Review.—So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. *It shall* (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) *hold unlaw-*

[13] Section 10(e)(B)(5) provides that the reviewing court shall hold unlawful and set aside agency action, findings, and conclusions found to be "(5) unsupported by substantial evidence in any case subject to the requirements of Sections 7 and 8 *or otherwise reviewed on the record of an agency hearing provided by statute.*" That Sections 7 and 8 were not applicable to the Tax Court hearing in this case does not affect the applicability of Section 10(e)(B)(5) to this proceeding since this is a "case . . . otherwise reviewed on the record of an agency hearing provided by statute." 26 U.S.C. §§ 1116, 1141, 53 Stat. 160, 164. The Circuit Court of Appeals for the Sixth Circuit has held Section 10(e) to be applicable under comparable circumstances. *National Labor Relations Board* v. *Thompson Products, Inc.*, 162 F. (2d) 287 (C.C.A. 6th, 1947).

> *ful and set aside agency action, findings, and conclusions found to be* (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) *unsupported by substantial evidence* in any case subject to the requirements of Sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. *In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party,* and due account shall be taken of the rule of prejudicial error." (emphasis supplied)

Although Section 10(e)(B)(5) uses the familiar formulation of "substantial evidence", it is clear that the Act was intended to enlarge in two respects the scope of review of administrative action theretofore followed by the courts. The first aspect of the intended enlargement is that the term "substantial evidence" means precisely what it says and does not mean merely any evidence or a scintilla of evidence. The second aspect is that a reviewing court in determining whether there is substantial evidence in the record to support an agency finding, is required to review the whole record and not simply to examine those items of evidence which support the agency action.

The Report of the Senate Judiciary Committee (Sen. Doc. No. 248, pp. 214, 216-17) states in part as follows:

> "'Substantial evidence' means evidence which on the whole record is clearly substantial, sufficient to support a finding or conclusion under Section 7(c), and material to the issues.
>
> • • •
>
> "The 'substantial evidence' rule set forth in Section 10(e) is exceedingly important. As a matter of lan-

guage, substantial evidence would seem to be an adequate expression of law. The difficulty comes about in the practice of agencies to rely upon (and of courts to tacitly approve) something less—to rely upon suspicion, surmise, implications, or plainly incredible evidence. It will be the duty of the courts to determine in the final analysis and in the exercise of their independent judgment, whether on the whole record the evidence in a given instance is sufficiently substantial to support a finding, conclusion, or other agency action, as a matter of law. In the first instance, however, it will be the function of the agency to determine the sufficiency of the evidence upon which it acts—and the proper performance of its public duties will require it to undertake this inquiry in a careful and dispassionate manner. Should these objectives of the bill as worded fail, supplemental legislation will be required."

Almost identical language is contained in the House Judiciary Committee's Report (Sen. Doc. No. 248, pp. 279 *et seq.*).[16]

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[16] Although Section 10(e) makes perfectly clear that the Circuit Courts of Appeals are required to review the whole record, this is underscored by the following exchange in the course of the House Committee Hearings between Mr. Carl McFarland, Chairman of the American Bar Association's Special Committee on Administrative Law, and Mr. Fadjo Cravens, a member of the House Judiciary Committee:

"Mr. Cravens. I think what we are trying to find out is, in your judgment, based on your experience, is judicial review adequate which is based upon a finding of the reviewing court that there was substantial evidence to support the facts as found by the agency below?

"Mr. McFarland. That is right. That does not mean, as we sometimes hear it said, that they look only to certain pages of the record. You might have in the record something which would sustain the judgment; on the other hand, there might be incontrovertible evidence in the remainder of the record which utterly destroys it. The review must be of the whole record in the sense that any part of the record can be called upon." (Sen. Doc. No. 248, pp. 85-86)

We read the *Scottish-American* case as constituting in so many words a direction to the Circuit Courts of Appeals to look solely to the evidence supporting the Tax Court's findings, and if that be substantial, to affirm.[15] Nothing could be clearer than that the Administrative Procedure Act denies to the reviewing court the right to examine merely the evidence supporting the findings of the Tax Court. All of the evidence relating to the particular issue under attack must be examined. If from an examination of all of the evidence, the findings of the Tax Court can be said to have substantial support, then they must be affirmed.

Further support for the view that an enlargement of the scope of judicial review was intended by the Administrative Procedure Act can be found in the Labor Management Relations Act, 1947,[16] and its legislative history. Section 10(e) of that Act provides that:

> "The findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive."

The Congressional committee reports relating to this section make it clear that Congress, by the use of this language, intended materially to broaden the preexisting

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[15] "The judicial eye must not in the first instance rove about searching for evidence to support other conflicting inferences and conclusions which the judges or the litigants may consider more reasonable or desirable. It must be cast directly and primarily upon the evidence in support of those made by the Tax Court. If a substantial basis is lacking the appellate court may then indulge in making its own inferences and conclusions or it may remand the case to the Tax Court for appropriate proceedings. But if such a basis is present the process of judicial review is at ~~hand~~." *Commissioner* v. *Scottish-American Investment Co., Ltd.*, 323 U. S. 119, 124 (1944)

[16] Pub. L. 101, 80th Cong. 1st Sess., June 23, 1947.

scope of judicial review of the decisions of the agency with which it was dealing.[17] It may be presumed that the use of substantially the same language in the Administrative Procedure Act was prompted by the same intention.

In *The Lincoln Electric Company* v. *Commissioner,* 162 F. (2d) 379 (1947), the Circuit Court of Appeals for the Sixth Circuit concluded that the effect of the Administrative Procedure Act was to broaden the scope of judicial review of Tax Court decisions. The court said:

> "While our conclusion is that review of the Tax Court decisions is governed by the Administrative Procedure Act, it does not become necessary, in view of our reliance upon the *Bingham* case, to particularize in what respect our power to review has been enlarged, except to say that it doubtless has been broadened and that it will be time enough to consider the precise application of the Act when clear-cut questions of fact or mixed questions of fact and law are brought to us for review."

The Circuit Court of Appeals for the Seventh Circuit has reached a contrary conclusion. *Anderson* v. *Commissioner,* C.C.A. 7th, Docket Nos. 9084, 9085, decided December 17, 1947, 48-5 CCH Standard Federal Tax Reports, para. 9109.

Although, strictly speaking, these conclusions in the *Lincoln Electric* and *Anderson* cases were unnecessary to decision and *dicta,* they serve to show the prevailing confusion and to underscore the necessity for a definitive determination by this Court.

We do not consider it appropriate in this petition for certiorari to set out in detail the evidence showing that

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[17] Report of the Senate Committee on Labor and Public Welfare, Sen. Rep. 105, 80th Cong. 1st Sess.; Conference Report on Labor Management Relations Bill, 1947 (H.R. 3020), H. Rep. 510, 80th Cong., 1st Sess.

the standards of the Administrative Procedure Act have not been satisfied by the Tax Court's decision. But it is appropriate to state at least that this case is peculiarly one in which the Tax Court's decision could not stand if tested by the requirement that it be supported by substantial evidence on an examination of the record as a whole. The Tax Court rested its decision upon its conclusion that the petitioner had not sustained its burden of proving that the disallowed payments were not a distribution of corporate profits in the guise of compensation for services. (R. 164.) The findings and opinion are silent as to any rational basis for this conclusion.

By every criterion, the payments that were made constituted compensation and not a distribution of earnings. For example, (1) petitioner's board of directors, among whose members were substantial stockholders, unrelated to those whose compensation is in question and not employed by the petitioner, unanimously approved the payments and characterized them as additional compensation (R. 68-78); (2) a liberal dividend policy was followed both in the taxable year and in prior years (R. 133, 25); (3) general wage increases and bonus payments to a substantial number of other employees had been put into effect by the petitioner in the taxable year (R. 37, 56, 63, 129-131); (4) the payments bore no relationship to stockholdings (R. 138, 29); (5) there were a substantial number of shareholders and the officers receiving the compensation, even with their immediate families, owned only 34.8 percent of the total capital stock of the petitioner (R. 138, 29); and finally (6) although filing sharply specific objections to certain requested findings, the respondent did not object to so much of petitioner's requested findings as stated that the payments were compensation and not a distribution of earnings in the guise of compensation. (R. 154-156.)

This petition presents for the determination of this Court the question of the scope of the judicial review of Tax Court decisions in the light of the Administrative Procedure Act. The public importance of obtaining an early decision by this Court is manifest. In the past five years, numerous decisions of this Court, commencing with the *Dobson* case, have considered the scope of judicial review of Tax Court decisions. Doubt has been cast upon the continued pertinence of many of these decisions by the enactment of the Administrative Procedure Act.

II.

The principle of *Securities and Exchange Commission v. Chenery Corporation* and prior decisions of this Court is applicable to decisions of the Tax Court. The probable conflict between the decision of the court below and those decisions requires the issuance of a writ of certiorari.

The Tax Court made no findings as to whether or not the petitioner's 1942 payments to its executive officers constituted reasonable compensation. This was the only genuine issue presented for its determination. Instead, its decision disallowing a portion of petitioner's 1942 payments rested solely upon its conclusion that the petitioner had failed to satisfy its burden of proving that such payments did not constitute a distribution of earnings in the guise of compensation. (R. 164.) Respondent in its brief below sought to eke out of the Tax Court's findings and opinion as an additional ground for decision a finding that the disallowed amounts were unreasonable as compensation. Because of the manner in which the court below affirmed the decision of the Tax Court, we are unable to ascertain whether the Circuit Court of Appeals reached or decided this question. Numerous decisions of this Court preclude the

reviewing court from encroaching upon the domain of the Tax Court by supplying the findings that the Tax Court failed to make and thereby making specific what the Tax Court left vague.[18]

The Tax Court found that "the compensation paid to the three Meyer executives totaling $67,000 for the fiscal years ending September 30, 1941, and September 30, 1942, respectively, was reasonable." (R. 161.) It is, of course, one thing to find that compensation of $67,000 is reasonable and quite another to find that *only* $67,000 is reasonable, or that *no more than* $67,000 would be reasonable. The Tax Court allowed petitioner's deduction of the $67,000 and the finding as made was essential for that purpose. Having determined that the amounts paid in excess of $67,000 constituted a distribution of profits and were unallowable as such, the Tax Court had no occasion to determine, and did not determine, whether, if such amounts had been compensation, they would have been unreasonable. That the Tax Court did not decide this question is clear from its opinion.

In the Tax Court, following the view of Dean Griswold,[19] petitioner had urged that the Commissioner was without statutory authority to disallow the deduction of compensation paid in good faith as the purchase price for services actually rendered. If the Tax Court had decided that the amounts in excess of $67,000 were compensation and unreasonable as such, it could not have avoided deciding this

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[18] Of course, if this Court should conclude that such findings were made by the Tax Court, the question still remains whether such a determination can stand under the enlarged scope of judicial review provided by the Administrative Procedure Act.

[19] Griswold, *New Light on a "Reasonable Allowance for Salaries"* 59 Harv. L. Rev. 286 (1945).

issue. See, *e.g. Walts, Inc.* v. *Commissioner,* CCH Tax Court Service, Dec. 15,566 (M) (1947). But in view of its conclusion that the amounts paid constituted a distribution of profits rather than compensation, the Tax Court expressly stated that it was unnecessary for it to decide this question. (R. 165.)

Moreover, the disallowance of the amounts paid in excess of $67,000 was made expressly dependent upon the characterization of such amounts as a distribution of profits rather than compensation. (R. 164.) Nowhere else in its findings and opinion, and for no other reason, does the Tax Court disallow these amounts.

The syllabus, which is prepared or approved by the Tax Court Judge as a part of the opinion, states the decision to rest solely upon the ground that the petitioner "has not carried its burden of establishing that such amount was not, in fact, distributed as profits in the guise of compensation." (R. 156.) The syllabus is, we think, clear evidence of what the Tax Court Judge thought that he was deciding and is confirmed by the portions of the opinion described above.[20]

It is true that the Tax Court commenced its opinion with a discussion of certain of the evidence bearing upon the reasonableness as compensation of the amounts paid

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[20] Mabel Owen, the official reporter to the Tax Court for the past twenty years, has advised us that only once in that time has her office been requested to prepare a headnote; that it is the invariable practice in the Tax Court for the headnotes to be prepared by the Judge, or by his law clerk and then approved by the Judge. It is a part of the final opinion as it leaves the Judge's chambers for filing. That this is the Tax Court's practice was confirmed by Mr. Robert C. Tracy, Secretary to the Tax Court.

in 1942 in excess of the $67,000 allowed. It is equally true that its discussion of such evidence had a tone adverse to the petitioner's claim of reasonableness. For example, after again stating in its opinion that the total compensation of $67,000 was reasonable for the year 1941, the Tax Court stated that, "We find, however, no additional facts that would justify an additional increase for the fiscal year ending September 30, 1942."

But this is not a finding on the essential issue of the reasonableness of the deduction in 1942 in the absence of a finding that *no more* than $67,000 was deductible in 1941. The question for the Tax Court is not whether there were additional facts warranting an increase over 1941, but whether the deduction in 1942 was reasonable. Petitioner could very properly, and in our view did, pay its executives less than the maximum reasonable compensation in 1941 and could increase that amount without any change in petitioner's financial position. That is the common situation with respect to the great bulk of salary increases.

The absence of critical findings does not constitute a mere technical omission which may be cured either by the Circuit Court of Appeals or this Court. The necessity for such a finding is a substantive one and goes to the heart both of the administrative process and this Court's power of review.

The decisions of this Court make clear that where essential facts are not clearly found, or the decision is based upon an erroneous ground, the reviewing court will not speculate as to the findings which the administrative agency would have made or substitute another ground upon which the decision could be sustained. In such cases, the proceedings must be remanded for further proceedings

before the administrative agency involved. And this is so even where the opinion of the agency contains intimations or subsidiary findings which permit an inference as to the omitted ultimate finding of fact. Were this not the case, the agency would be relieved of its responsibilities and the reviewing courts rendered unable to discharge theirs.

Nowhere has this basic conception been better stated than in the recent decision of *Securities and Exchange Commission* v. *Chenery Corporation*, 332 U.S. 194 (1947). There the Court said (at 196-7):

> "When the case was first here, we emphasized a simple but fundamental rule of administrative law. That rule is to the effect that a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency. If those grounds are inadequate or improper, the court is powerless to affirm the administrative action by substituting what it considers to be a more adequate or proper basis. To do so would propel the court into the domain which Congress has set aside exclusively for the administrative agency.
>
> "We also emphasized in our prior decision an important corollary of the foregoing rule. If the administrative action is to be tested by the basis upon which it purports to rest, that basis must be set forth with such clarity as to be understandable. It will not do for a court to be compelled to guess at the theory underlying the agency's action; nor can a court be expected to chisel that which must be precise from what the agency has left vague and indecisive. In other words, 'We must know what a decision means before the duty becomes ours to say whether it is right or wrong.' *United States* v. *Chicago, M. St. P. & P. R. Co.*, 294 U.S. 499, 511, 55 S. Ct. 462, 467, 79 L. Ed. 1023."

To the same effect are *Securities and Exchange Commission* v. *Chenery Corporation,* 318 U.S. 80, 94-5 (1943), *Phelps Dodge Corp.* v. *National Labor Relations Board,* 313 U.S. 177, 197 (1941), *Beaumont, Sour Lake & Western Railway Company* v. *United States,* 282 U.S. 74, 86 (1930); *United States* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.,* 294 U.S. 499, 510-11 (1935); *United States* v. *Carolina Freight Carriers Corp.,* 315 U.S. 475, 488-89 (1942); *Atchison, Topeka & Santa Fe Railway Co.* v. *United States,* 295 U.S. 193, 201-2 (1935).

The Circuit Courts of Appeals, reviewing decisions of the Tax Court, uniformly follow the practice of remanding because of omitted or ambiguous findings. *Lewis* v. *Commissioner,* 160 F. (2d) 839 (C.C.A. 1st, 1947); *Doernbecher Mfg. Co.* v. *Commissioner,* 80 F. (2d) 573 (C.C.A. 9th, 1935).

Regardless of the application of the Administrative Procedure Act, and the scope of judicial review provided thereby, it is of the highest importance that this Court make clear the necessity for unmistakable findings of fact and decision of the issues as a condition precedent to judicial review of Tax Court decisions. If the findings or the basis for decision of the Tax Court are omitted or unclear, the reviewing court is prevented from playing its part in the statutory scheme since it is unable to determine whether the ground of decision is a legally permissible one and whether the findings are supported by legally sufficient evidence. And for the reviewing court to attempt to fill the interstices would be to encroach upon the fact finding duties and responsibilities of the Tax Court.

WHEREFORE, the petitioner prays for the allowance of a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit in the case entitled *Glenshaw*

Glass Company, Inc., petitioner, v. *Commissioner of Internal Revenue*, respondent, No. 9375, in order that this case may be reviewed and determined by this Honorable Court.

GLENSHAW GLASS COMPANY, INC.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 537

GLENSHAW GLASS COMPANY, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

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MAY IT PLEASE THE COURT:

I.

The petition for certiorari demonstrates that the Administrative Procedure Act governs the judicial review of Tax Court decisions and enlarges the scope of that review. These are important questions of federal law that have not been but should be decided by this Court.

Without joining issue on these questions or denying their importance, the respondent seeks to avoid the granting of the writ by the assertion that since the decision below must be affirmed under any theory of judicial review these ques-

tions are not presented. This argument misses the mark for several reasons.[1]

In the first place, we do not believe that the review by this Court of important legal questions rests upon an *a priori* decision as to whether affirmance or reversal will result in the particular case. Here, such a practice would only serve indefinitely to postpone decision, encourage litigation and impede the proper administration of the revenue laws in the courts below.

In the second place, assuming for the moment that respondent's view of the evidence is the correct one, the assigned questions are nonetheless presented for decision. For example, the requirement of the Administrative Procedure Act that the agency action must be supported by substantial evidence upon a review of the whole record probably makes the scope of review somewhat less than a weighing of the evidence *de novo* and somewhat more than an examination of only the evidence in support of the agency action. The preliminary determination called for by the respondent that the decision below must be affirmed even if the Administrative Procedure Act applies, inevitably requires a drawing of the line between those two extremes, and, hence, a decision as to the nature of the

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[1] In a footnote, respondent does seem to suggest that the scope of judicial review has not been enlarged by the Administrative Procedure Act. (Resp. Br. 10, fn. 4). The legislative history and decisions to the contrary have been set out in the petition. (Pet. 14-20). It should be noted that not only does the respondent ignore the Administrative Procedure Act requirement that the findings be supported by substantial evidence *upon a review of the "whole record"*, but that the legislative history relied upon does not support the respondent's position. The statements by Senator McCarran seem to justify quite a different conclusion. And the extension of remarks by Representative Hobbs consists of a portion of an anonymous Department of Justice memorandum. As this Court knows, extensions of remarks are not made upon the floor of the House, and this particular extension of remarks seems to be merely a clumsy "plant" of purported legislative history.

judicial review under that Act. Decisions of that importance should not be made in silence. Seductive assumptions that a particular decision must be affirmed upon any theory of judicial review serve simply to conceal a lack of analysis and a refusal to come to grips with and decide the actual problems presented. Responsible disposition of this, as well as other Tax Court decisions, can be obtained only when the applicable standards of judicial review are clearly known and the particular decision is tested against those standards.

And finally, the respondent's view that affirmance is inevitable is simply not supported by the record facts. The Tax Court found that the amounts paid in 1942 in excess of $67,000 were a distribution of earnings and not compensation. This ground for decision was selected by the Tax Court to the exclusion of any other. If the judicial eye is to be confined by *Scottish-American* blinders,[2] to an examination of only that evidence which may be said to support the findings made by the Tax Court, we do not say that affirmance might not result. But if the Administrative Procedure Act applies and if the judicial eye is free to examine the entire record, then we say that the Tax Court's findings and decision can not stand. The petition for certiorari summarizes the overwhelming evidence which deprives the findings of any substantial basis. (Pet. 19). Moreover, respondent wholly abandons the defense of the only ground selected by the Tax Court for its decision and asserts that the "basic and only issue" was the reasonableness of the payments as compensation. (Resp. Br. 10-11). This case peculiarly presents for exploration and decision the meaning of the "review of the whole record" requirement of the Administrative Procedure Act.

The start must be made somewhere. It may be assumed that respondent will always assert that Tax Court findings

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[2] *Scottish-American Investment Co., Ltd.*, v. *Commissioner*, 323 U. S. 119, 124 (1944).

in his favor must be sustained under any theory of judicial review. What is important is that an authoritative determination be had as to whether the Administrative Procedure Act has enlarged the area over which the judicial eye may rove, or whether the Act is simply declaratory of preexisting law. Once those fundamental principles have been settled by this Court, the Circuit Courts of Appeals can proceed with a case by case application of the standards of the Act. The urgency of an early statement by this Court cannot be overstressed.

II.

To the extent that the decision of the Circuit Court of Appeals affirmed the judgment of the Tax Court upon the ground that the disallowed amounts constituted unreasonable compensation, that decision is in conflict with the *Chenery* cases.[3]

The Tax Court did not decide the question of whether the increases in the amounts paid in 1942 were reasonable as compensation. The petition clearly shows that the sole ground for the Tax Court's decision was its conclusion that the 1942 increases represented, not compensation, but a distribution of dividends. (Pet. 20-24). Having decided this, there was no occasion for the Tax Court to decide, and it did not decide, whether the disallowed amounts would have been reasonable as compensation.[4]

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[3] *Securities and Exchange Commission* v. *Chenery Corporation*, 318 U. S. 80, 94-5 (1943); *id.* 332 U. S. 194, 196-7 (1947).

[4] The closest approach to a decision of that issue is the statement that nothing occurred in petitioner's business during 1942 that would warrant a substantial increase in the salaries paid. (R. 163). This is not and can not be interpreted as a finding that if the disallowed amounts were compensation they would have been unreasonable since it ignores the possibility that the compensation paid in 1941 and allowed in its entirety by the Tax Court was not the maximum that could reasonably have been paid.

Respondent would substitute what he terms the "plain tenor" of the findings and opinion for this deficiency and place the decision of the Tax Court upon a basis wholly different from that expressly selected by it. The so-called "plain tenor" is no substitute for missing essential findings.[5]

It is plainly improper for the reviewing court to supply missing essential findings, to make precise what the Tax Court left vague or to substitute an alternative ground for that selected as the basis of decision by the Tax Court itself. To do so is for the reviewing court to propel itself into the fact-finding arena where it does not belong. And in view of the great weight given to the findings and decisions of the Tax Court, it is imperative that those findings be stated with precision. Otherwise the reviewing courts might give controlling weight to findings or a decision not

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[5] Certain misstatements in respondent's brief require correction. Contrary to the assertion in footnote 5 (pp. 10-11), the petitioner has never stated that the Tax Court did not find that $67,000 was reasonable for 1942. Petitioner merely asserts that the Tax Court did not find that any compensation in excess of $67,000 would have been unreasonable. Such a finding was unnecessary since, in the Tax Court's view, the amounts paid in excess of $67,000 were not compensation but a distribution of earnings.

Respondent's attempt to draw some prejudicial inference from the taxpayer's acquiescence in the Commissioner's computation of the 1942 deficiency based upon the Tax Court's allowance of $67,000, rests either on ignorance or lack of candor. (Resp. Br. 11, fn. 5). As Rule 50 of the Tax Court's Rules of Practice and Procedure makes clear, the petitioner's acquiescence is confined solely to the mathematical accuracy of the computation and is without prejudice to petitioner's right to contest the basis of the Tax Court's decision.

At page 9 respondent asserts that "Under the circumstances, the Tax Court was fully justified in concluding that taxpayer failed to meet its burden of proving that the amount of $127,479.85 it deducted for 1942 represented reasonable compensation." No such conclusion was reached by the Tax Court. It concluded that $67,000 was reasonable as compensation and that the taxpayer had not met its burden of proving that the balance did not constitute a distribution of earnings. (R. 161, 164).

in fact the product of the Tax Court's special competence. These considerations call for the strict application to the Tax Court of the principles of the *Chenery* cases.

CONCLUSION

For the reasons heretofore given, a writ of certiorari to the Circuit Court of Appeals for the Third Circuit should be allowed.

Respectfully submitted.

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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 537

GLENSHAW GLASS COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 156a–165a)[1] is not reported. The per curiam opinion of the Circuit Court of Appeals (R. 167) has not yet been reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered October 21, 1947. (R. 168.) The petitioner for a writ of certiorari was filed January 17, 1948. The jurisdiction of this Court is

[1] Record references are to the separately bound printed "Appendix" filed with taxpayer's petition.

invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's decision that $67,000 was a reasonable salary allowance under Section 23 (a) (1) (A) of the Internal Revenue Code for the services of taxpayer's three officers and controlling stockholders during its fiscal year 1942.

STATUTE AND REGULATIONS INVOLVED

These appear in the Appendix, *infra*, pp. 14–16.

STATEMENT

The facts found the Tax Court (R. 157a–161a) may be summarized as follows:

Since its incorporation in 1900 taxpayer has engaged in the manufacture of glass bottles and containers. It reports its income on the basis of fiscal years ending September 30. The three Meyer brothers—Samuel, George, and Albert—were associated with taxpayer for many years as its executive officers. During the taxable years,[2] Samuel was president, treasurer, general manager and sales manager; George was secretary, assistant treasurer, and assistant manager in charge of

[2] Only the fiscal year 1942 is involved in this appeal. The Tax Court overruled the Commissioner's determination *in toto* as to the fiscal year 1941, and in part as to the fiscal year 1942. (R. 163a–164a.) The Commissioner did not cross-appeal.

production; and Albert was in charge of engineering and designing. (R. 157a.) Taxpayer had 6,000 shares of stock outstanding, of which the Meyer family owned 3,432 shares, the Beck and Berner families respectively owned 1,437 and 958 shares, and the remaining 173 shares were owned by others. A voting trust formed in 1939 of which the three Meyer brothers were the voting trustees held 3,017 shares (about 51% of the total), of which 2,958 were owned by the Meyer family, 48 by one Murphy, and 11 by one Heinl. Murphy and Heinl were employees of taxpayer. The board of directors during 1941 consisted of the three Meyer brothers, Ruth Meyer (a sister), a member of the Beck family (who was related to Samuel Meyer's wife), a member of the Berner family, and Heinl. The board was the same during 1942, except that Murphy was elected in place of Ruth Meyer. (R. 158a, 162a.)

The Meyer brothers were eminently qualified to conduct the business, and under their progressive management taxpayer made a net profit in each of the twenty years ending with 1942. It had paid a dividend in each of those years except in 1934, and in the taxable years the dividends totaled 16% of the capital stock. The book value of the stock increased from less than $60 per share in 1921 to $212 in 1941 and $234 in 1942. Taxpayer's plant and equipment were modern, up-to-date improvements being financed from earnings. During the taxable years and for many years

prior thereto taxpayer operated on a 24-hour and 7-day week basis, and had an average of from 350 to 375 employees. The three Meyer brothers had no executive assistants and worked long hours, taking no vacations in the taxable years nor, with one exception, in the previous 10 to 15 years. (R. 157a–158a.) The net sales, the net income before executives' compensation and federal taxes, the total salaries paid the three Meyer brothers, the earned surplus, and the cash dividends, during the 10-year period from 1933 through 1942 were as follows (R. 159a):

Year	Net sales	Net income before executive salaries and Federal taxes	Total executive salaries	Earned surplus	Cash dividend paid
1933	$673,751.63	$93,259.45	$27,900.00	$386,805.45	4.80
1934	692,414.69	36,011.25	20,925.00	394,544.74	0.00
1935	1,099,892.20	31,614.78	27,900.00	395,067.72	1.00
1936	1,374,909.55	133,392.57	27,900.00	468,939.85	4.00
1937	1,908,865.07	319,009.42	31,000.00	588,103.42	12.47
1938	1,622,277.34	104,627.55	37,750.00	616,281.11	1.00
1939	1,912,698.81	209,953.39	37,000.00	764,850.18	2.25
1940	2,008,039.56	179,977.75	37,000.00	858,252.81	4.00
1941	2,416,310.93	249,643.24	67,000.00	950,361.84	8.00
1942	2,700,910.21	447,533.62	127,479.85	983,012.00	8.00

The increase in sales for 1942 was due to higher prices and the increased war demand for taxpayer's products. (R. 163a.)

For the fiscal year ending September 30, 1941, the annual salaries of the Meyer brothers had been fixed at $14,000 for Samuel, $12,000 for George, and $11,000 for Albert. At a meeting of taxpayer's board of directors held August 20, 1941, it was resolved that additional compensation of

$10,000 be paid to each of the Meyer brothers; this resolution was unanimously adopted and was ratified at a stockholders' meeting held November 19, 1941. At a subsequent meeting of the board of directors, held February 4, 1942, it was resolved that for the fiscal year ending September 30, 1942, the annual compensation of the Meyer brothers should be $24,000 for Samuel, $22,000 for George, and $21,000 for Albert; and that, in addition to these fixed sums, each was to be paid, on or before November 15, 1942, 7½% of the net profits of the company for that fiscal year computed after deducting the sum of $45,000 but before deducting income taxes and the percentage of net profits to be paid to them. Each of the Meyer brothers refrained from voting upon his own compensation, and the resolutions were ratified at a stockholders' meeting on November 18, 1942. Later in the year 7½% of the company's net profits based on a certain formula was set aside for payment of bonuses to key employees. (R. 159a–161a.)

In its 1941 and 1942 tax returns taxpayer deducted $67,000 and $127,479.85, respectively, as compensation paid to the three Meyer brothers. The Commissioner determined that not more than $37,000 constituted reasonable compensation in each year, and disallowed deduction of the excess. (R. 6a–7a, 163a–164a.) The Tax Court found that $67,000 constituted reasonable compensation in each year (R. 161a); accordingly it overruled

the Commissioner's determination *in toto* as to the year 1941 and sustained it in part as to the year 1942 (R. 161a–165a.). Taxpayer appealed from that portion of the Tax Court's decision which partially sustained the Commissioner's determination for 1942. (R. 166a.) The Circuit Court of Appeals affirmed per curiam without an opinion. (R. 167.)

ARGUMENT

1. Whether a salary payment is "reasonable," and hence deductible as an "ordinary and necessary" business expense under Code Section 23 (a) (1) (A) and the long-standing applicable Treasury Regulations (Appendix, *infra*), presents a pure question of ultimate fact. Taxpayer had the burden of proving that the claimed deduction was reasonable in amount (*Botany Mills* v. *United States,* 278 U. S. 282, 289), and the Tax Court's finding of the amount constituting reasonable compensation is entitled to finality on appeal if supported by substantial evidence (*Commissioner* v. *Flowers,* 326 U. S. 465, 470; *McDonald* v. *Commissioner,* 323 U. S. 57, 64–65; *Commissioner* v. *Heininger,* 320 U. S. 467–475; *Trust of Bingham* v. *Commissioner,* 325 U. S. 365, 370; *Long Island Drug Co.* v. *Commissioner,* 111 F. 2d 593 (C. C. A. 2d), certiorari denied, 311 U. S. 680).

The record unquestionably warrants the Tax Courts finding (R. 161, 163) that $67,000 represented reasonable compensation for the services

of taxpayer's three executive officers—the Meyer brothers—during its 1942 fiscal year. As is plain from its opinion, the Tax Court weighed all the relevant factors, those favorable to taxpayer as well as those unfavorable. The compensation of the three Meyer brothers had just been increased from $37,000 in 1940 to $67,000 in 1941, an increase of over 80%. (R. 159a.) The Tax Court, overruling the Commissioner's determination that only $37,000 was reasonable, concluded that this increase was justified by the nature of their services and allowed the full $67,000 claimed for 1941. (R. 163a.) For 1942, the taxable year here involved, taxpayer claimed a deduction of $127,479.85 as compensation to the Meyer brothers, of which $67,000 represented fixed salaries and $60,479.85 represented 22½% of its 1942 net profits (7½% to each brother). (R. 160a–161a, 163a–164a.) It is this *further* increase in compensation—an increase of about 90% over the 1941 compensation of $67,000—which the Tax Court concluded was excessive. (R. 163a–165a.) The court pointed out (R. 163a), and taxpayer does not deny, that the only fact adduced to justify deduction of such a substantial percentage of taxpayer's net profits as compensation to the Meyer brothers—in addition to their already increased fixed salaries—was an increase in its net sales for that year. This factor, while relevant, is by no means conclusive of the reasonableness of the compensation paid (*Clinton Co.* v.

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Commissioner, 159 F. 2d 102 (C. C. A. 7th); *Long Island Drug Co.* v. *Commissioner, supra*); especially where, as here (R. 163a), the increase in sales was not attributable to increased services but to the war demand and higher prices for taxpayer's goods (cf. *Miller Mfg. Co.* v. *Commissioner,* 149 F. 2d 421, 423 (C. C. A. 4th)). Moreover, as the Tax Court further noted (R. 164a), the additional compensation for 1942 was measured by a percentage of taxpayer's net profits; provided for the same percentage (7½%) to each of the Meyer brothers, although their fixed salaries differed; and was not awarded before their services were rendered, but after operational results for the first quarter were known. See Section 19.23 (a)–6 (2) of Treasury Regulations 103 (Appendix, *infra*). What is more, the compensation was not fixed by an arms length bargain; the Meyer brothers were the controlling stockholders and directors of taxpayer (R. 158a, 162a),[3] an important factor to be considered. *Crescent Bed Co.* v. *Commissioner,* 133 F. 2d 424 (C. C. A. 5th). Nor was any competent proof

[3] The Tax Court found (R. 158a, 162a), and it is not disputed, that the Meyer family owned 3,432 of the 6,000 outstanding shares of taxpayer; that a voting trust of which the Meyer brothers were voting trustees held 51% of the shares; and that three of the seven directors were the Meyer brothers themselves, while two of the other directors (Murphy and Heinl) were employees who had deposited their stock in the voting trust and shared in a bonus awarded at the same time that the additional compensation to the Meyer brothers was awarded.

offered by taxpayer to afford a comparison of the compensation it paid the Meyer brothers with that paid "for like services by like enterprises under like circumstances". Section 19.23 (a)–6 (3) of Treasury Regulations 103 (Appendix, *infra*); *Clinton Co.* v. *Commissioner, supra.* As the Tax Court observed (R. 162a), taxpayer's so-called expert witnesses were not qualified to express an expert opinion; and even assuming they qualified, the Tax Court would not have been bound by their opinion. *In re Rae's Estate,* 147 F. 2d 204 (C. C. A. 3d); *L. & C. Mayers Co.* v. *Commissioner,* 131 F. 2d 309 (C. C. A. 2d), certiorari denied, 318 U. S. 773.

Under the circumstances the Tax Court was fully justified in concluding that taxpayer failed to meet its burden of proving that the amount of $127,479.85 it deducted for 1942 represented reasonable compensation. Indeed, the Tax Court was more than liberal in overruling the Commissioner's determination that $37,000 was reasonable, and in allowing $67,000 instead. Under familiar rules governing the scope of judicial review of the Tax Court's factual determinations, affirmance of its decision by the court below was clearly correct.

2. Taxpayer's elaborate discussion (Pet. 4–25) of the scope of appellate review of Tax Court decisions is academic. For even assuming, *arguendo,* that the Administrative Procedure Act, c. 324, 60 Stat. 237, applies to the Tax Court

and also that it "enlarges" the scope of review of its decisions,[4] affirmance of the Tax Court's decision by the court below was correct. Taxpayer's argument reduces itself, in terms of this case, simply to the contention (Pet. 3, 20–24) that the court below was precluded from affirming the Tax Court's decision because "no finding" was made as to the reasonableness of the claimed salary deduction for 1942. To so contend, however, is to disregard the plain tenor of the Tax Court's findings and opinion.[5] The

[4] The standards prescribed in Section 10 of the Administrative Procedure Act for review of administrative agency actions are essentially the same as those prescribed in Section 1141 (c) of the Internal Revenue Code for review of Tax Court decisions. The so-called "substantial evidence" rule embodied in Section 10 (e) (B) (5) of that Act has long been applied upon review of Tax Court decisions. See, e. g., *Helvering* v. *Rankin*, 295 U. S. 123, 131; *Wilmington Co.* v. *Helvering*, 316 U. S. 164, 168; *Dobson* v. *Commissioner*, 320 U. S. 489. Besides, the legislative history of the Act indicates that it was not intended to alter existing rules governing the review of factual determinations by administrative agencies. The original draft of Section 10, prepared by the American Bar Association Committee on Administrative Law, carried the comment that its provisions were not intended to expand the scope of judicial review. 30 A. B. A. J. 46. See also, to the same effect, the statements by Senator McCarran, Chairman of the Senate Judiciary Committee, explaining the bill on the floor of the Senate. 92 Cong. Record, Part 2, pp. 2157–2159 (S. Doc. No. 248, 79th Cong., 2d Sess., pp. 321–322). And see Representative Hobbs' extension of remarks, 92 Cong. Record, p. A2987 (S. Doc. No. 248, *supra*, p. 415).

[5] At the outset of its opinion (R. 157a) the Tax Court stated that "The only issue submitted is the reasonableness of the compensation paid" for the two taxable years in-

basic and only issue before the Tax Court was whether the $127,479.85 claimed by taxpayer, or the $37,000 allowed by the Commissioner, or some in-between figure, represented a "reasonable" allowance; it properly addressed itself to that issue and found that $67,000 was reasonable. And the only question before the court below was whether that finding of ultimate fact was supported by substantial evidence. The evidentiary facts dispositive of this case are undisputed and, we submit, they support the Tax Court's decision "under any theory of judicial review". *Ander-*

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volved. After reviewing the evidence, it found (R. 161a, 163a–164a) that $67,000 was "reasonable" for each year. Taxpayer's insistence (Pet. 21, 23) that the Tax Court made no finding that $67,000 was reasonable for 1942 because it did not preface that figure with the word "only" is sheer quibbling. Indeed, taxpayer acquiesced in the Commissioner's proposed computation of the 1942 deficiency based on the Tax Court's allowance of $67,000. (R. 165a.)

Equally untenable is taxpayer's assertion (Pet. 3, 19, 20) that the Tax Court predicated its decision solely on the ground that the payment in excess of $67,000 represented a dividend distribution rather than compensation. True, in answer to taxpayer's contention below that it was not a dividend, the Tax Court in the concluding portion of its opinion (R. 164a) stated that taxpayer had not sustained the burden of proving that contention; but this was patently a cumulative ground for its decision. Nor is there any basis for taxpayer's corollary supposition (Pet. 19) that a distribution of corporate earnings which represents "compensation" rather than a dividend must be deemed a deductible business expense; to qualify for deduction under Section 23 (a) (1) (A) and the pertinent Regulations the "compensation" must be "reasonable." See *Long Island Drug Co.* v. *Commissioner*, *supra*, pp. 594–595.

son v. *Commissioner* (C. C. A. 7th), decided December 17, 1947 (1948 C. C. H., par. 9109); *Credit Bureau of Greater N. Y.* v. *Commissioner,* 162 F. 2d 7, 9 (C. C. A. 2d); *Dawson* v. *Commissioner,* 163 F. 2d 664, 667 (C. C. A. 6th).

3. Taxpayer does not and cannot allege conflict with any other decision. Its assertion (Pet. 20) of "probable conflict" with *Securities Comm'n* v. *Chenery Corp.,* 332 U. S. 194, and like decisions, rests entirely upon its gratuitous assumption that the Tax Court made "no findings" respecting the reasonableness of the claimed salary deduction. Far from precluding affirmance of the Tax Court's decision, the *Chenery* case demands it. This Court there held (p. 207) that upon review of an administrative agency action the appellate court's "duty is at an end" if the administrative action is "based upon substantial evidence" and does not lack a "rational and statutory foundation". Certainly its duty upon review of Tax Court decisions is no greater, for "every reason ever advanced in support of administrative finality applies to the Tax Court". *Dobson* v. *Commissioner,* 320 U. S. 489, 498.

CONCLUSION

There is no occasion for further review. This case presents a pure question of fact. Neither an important question nor a conflict is involved. The petition should therefore be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
> In computing net income there shall be allowed as deductions:
> (a) [As amended by Section 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—
> (1) *Trade or business expenses.*—
> (A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *
> (26 U. S. C. 1940 ed., Sec. 23.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.23 (a)-6. *Compensation for personal services.*—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:
> (1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. (a) An ostensible salary paid by a corporation may be a distribution of a dividend

on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stock holdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. (b) An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than

the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

* * * * *

Sec. 19.23 (a)–8. *Bonuses to employees.*— Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are not deductible from gross income.

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